

Internal Revenue Service
memorandum

CC:TL-N-2819-89

VWATERS

date: **14 APR 1989**

to: District Counsel CC:PIT:TL
Attn: Edward J. Laubach, Jr.

from: Acting Senior Technician Reviewer
Tax Shelter Branch CC:TL:TS

subject: Effect of Form 906 Closing Agreement on TEFRA Procedures

This is in response to your request of January 11, 1989,
for tax litigation advice regarding the above-captioned subject.

ISSUES

1. Whether the statute of limitations has expired for making assessments against taxpayers for the [REDACTED] and [REDACTED] taxable years?
2. Whether a Form 906 can be rescinded absent a showing of fraud, malfeasance or misrepresentation of a material fact?
3. Whether the Tax Court has jurisdiction to decide the validity of a closing agreement or whether a refund action is the only means to challenge such agreement?

BRIEF ANSWERS

1. The statute of limitations has expired for making assessments against the taxpayers for the [REDACTED] taxable year since the closing agreement was executed after the statutory period. However, the Service can make assessments for the [REDACTED] taxable year since the statute of limitations has been suspended.
2. A Form 906 Closing Agreement on Final Determination Covering Specific Matters cannot be rescinded absent a showing of fraud, misrepresentation or malfeasance.
3. The statutory notice issued to the taxpayers for the [REDACTED] taxable year gives the Tax Court jurisdiction to determine the validity of the closing agreement.

009062

FACTS

The taxpayers, [REDACTED], were limited partners in a TEFRA partnership known as [REDACTED]. On [REDACTED], the taxpayers executed a Form 906 Closing Agreement on Final Determination Covering Specific Matters relative to [REDACTED]. The Government executed the closing agreement on [REDACTED]. The pertinent provision in the closing agreement reads as follows:

3. [REDACTED] Losses, deductions, and credits with respect to [REDACTED] are not deductible by or allowable to the taxpayers in any year after [REDACTED].]

The revenue agent informed taxpayers that adjustments to tax were due in light of the closing agreement, but the taxpayers refused to consent to these adjustments. The Service issued statutory notices of deficiencies on [REDACTED], for the [REDACTED] taxable year and [REDACTED], for the [REDACTED] taxable year. The taxpayers filed the tax returns for both taxable years in a timely manner. No consent to extend the statutory period was executed for either taxable year.

The only adjustments in the notices were related to [REDACTED]. These notices included an I.R.C. § 6661 penalty for each year. The taxpayers filed timely petitions with the Tax Court asserting that the statute of limitations had expired for assessing deficiencies on the [REDACTED] and [REDACTED] taxable years (i.e. taxable years) and that the closing agreement was obtained by misrepresentation of a material fact. No assessment has been made against the taxpayers.

DISCUSSION

Section 7121 of the Code authorizes the Service to enter into closing agreements with taxpayers relating to tax liability. Final determinations of specific matters pursuant to section 7121 are ordinarily reflected on a Form 906. Closing agreements are always signed by the taxpayer before they are signed on behalf of the Commissioner. A properly executed Form 906 is a binding contract with finality as of the date the Service executes the agreement.

A Form 906 closing agreement which resolves all partnership items constitutes a settlement agreement which renders the partnership items of a partner nonpartnership items in accordance with section 6231(b)(1)(C). Section 6231(b)(1)(C) provides:

(b) Items Cease To Be Partnership Items In Certain Cases.-

(1) In general.- For purposes of this subchapter, the partnership items of a partner for a partnership taxable year shall become nonpartnership items as of the date-

.

(C) the Secretary enters into a settlement agreement with the partner with respect to such items[.]

I. The Period of Limitations

The Secretary may enter into a binding settlement agreement as to a partnership item with any partner. See I.R.C. § 6224(c)(1). Section 6229(a) generally provides for a period of limitations for the assessment of tax attributable to partnership items as being three years after the later of: (1) the date on which the partnership return was filed; or (2) the last day for filing such return for the year. Because [REDACTED] filed its tax returns on the basis of the calendar year, the [REDACTED] tax return should have been filed by [REDACTED]. See I.R.C. § 6072(a). Therefore, provided that the tax return was filed timely, the period of limitations for making assessments expired on [REDACTED]. The closing agreement, however, was executed on [REDACTED], and there was no consent to extent the statutory period for the taxpayers' [REDACTED] taxable year.

Section 6229(f) provides a special rule for items that become nonpartnership items. That section provides as follows:

(f) Items Becoming Nonpartnership Items.-- If, before the expiration of the period otherwise provided in this section for assessing any tax imposed by subtitle A with respect to the partnership items of a partner for a partnership taxable year, such items become nonpartnership items by reason of 1 or more of the events described in subsection (b) of section 6231, the period for assessing any tax imposed by subtitle A which is attributable to such items (or any item affected by such items) shall not expire before the date which is 1 year after the date on which the items become nonpartnership items. This period described in the preceding sentence (including any extension period under this sentence) may be extended with respect to any partner by agreement entered into by the Secretary and such partner (emphasis added).

With respect to the [REDACTED] taxable year, we believe that the closing agreement is invalid because it was executed after expiration the period of limitations. Although there is no definitive authority which states that a closing agreement executed after expiration of the statutory period is ineffective, we believe it is unlikely that a Court will hold that the closing agreement is valid, at least in the absence of a specific waiver in the closing agreement of the period of limitations. Moreover, because the closing agreement was entered into after expiration of the period of limitations, the one year period of limitations provided in section 6229(f) is inapplicable because that provision applies only to items becoming nonpartnership items before expiration of the period for making an assessment. Therefore, any assessment against the taxpayers for the [REDACTED] taxable year is barred by the period of limitations.

The taxpayers filed suit with the Tax Court for the [REDACTED] taxable year on [REDACTED], contending that the statutory period had expired for assessing the deficiency and that the closing agreement was obtained by duress and misrepresentation. When a taxpayer alleges that assessment is barred by the statute of limitations and makes a prima facie case by proving the filing date of the income tax return and the expiration of the statute of limitations period prior to the mailing of the notice of deficiency, the burden of going forward with the evidence shifts from the taxpayer to the Government. Smith v. Commissioner, T.C. Memo 1989-87 (citing Robinson v. Commissioner, 57 T.C. 735, 737 (1972)). The Government may discharge its burden by showing that in some manner the running of the period was suspended.

Because the government cannot meet its burden, there are two possible courses of action that may be taken. First, the Service could allow the Tax Court to render an adverse decision. We do not recommend this alternative because it is probable that the Government will be assessed attorneys' fees pursuant to section 7430. The other alternative would require the Government to concede the case. In order to concede a case which is pending in the Court, the District Counsel attorney must get approval from the Regional Counsel by submitting a Counsel Settlement Memorandum. If Counsel proposes to settle or concede an issue, the attorney must immediately prepare the Counsel Settlement Memorandum setting forth the basis for the settlement or concession. CCDM (35)841 discusses the specifics of a Counsel Settlement Memorandum. CCDM (35)842 sets forth the procedure to be taken where there is a settlement/concession after the trial has begun.

With respect to the [REDACTED] taxable year, the Service executed the closing agreement prior to the expiration of the statutory period. The execution of the closing agreement extended the

statutory period for assessment to [REDACTED], one year after the execution of the closing agreement. See I.R.C. § 6229(f). This one year statutory period was suspended on [REDACTED], when the Service issued a statutory notice of deficiency to the taxpayers. See I.R.C. § 6503(a). The taxpayers petitioned the Tax Court for redetermination of the deficiency which further suspended the statutory period. Section 6503(a) provides that where a proceeding with respect to a deficiency is placed on the docket of the Tax Court, the statutory period is suspended until the decision of the Tax Court becomes final, and for an additional 60 days thereafter.

Accordingly, it appears that the statutory period for assessing the deficiency for the [REDACTED] taxable year has not expired since it was suspended when the Government issued the valid statutory notice to the taxpayers and a proceeding with respect to the deficiency was placed on the docket of the Tax Court. At the time when the Service issued the statutory notice, section 6230(a)(2) provided that the deficiency proceedings applied to partnership items which became nonpartnership items by reason of a settlement agreement. Where the deficiency proceedings apply, the Service is required to issue a statutory notice prior to assessment. I.R.C. § 6213.

Subsequent to the issuance of the statutory notice, the Technical and Miscellaneous Revenue Act of 1988 ("TAMRA") amended section 6230(a)(2) to provide that the deficiency proceedings do not apply where items have become nonpartnership items by reason of a settlement agreement executed by the Service and a taxpayer. In light of TAMRA, statutory notices no longer need to be issued prior to assessment of a deficiency. Although the amendment to section 6230 is effective as if included in the Tax Reform Act of 1986, we believe that the period of limitations for assessing the deficiency has been suspended. The Service issued the statutory notice for the [REDACTED] taxable year on [REDACTED], and the taxpayers petitioned the Tax Court on [REDACTED]. Because the statutory notice was valid when issued and the Service is restricted from making the assessment while the action is pending in the Tax Court, we believe the period of limitations has effectively been suspended. See I.R.C. § 6503(a).

II. Rescission of the Closing Agreement

A closing agreement is final and conclusive unless there is a showing of fraud, malfeasance or misrepresentation of a material fact. I.R.C. § 7121(b). It is a binding contract with finality. Estate of Johnson v. Commissioner, 88 T.C. 225, 231 (1987). You stated in your request that the taxpayers would like to rescind the closing agreement for taxable years after [REDACTED] so as to receive the same treatment as other TEFRA partners. Generally, if the Service enters into a settlement

must submit a written statement no later than the later of: (1) the 150th day after the day on which the FPAA is mailed to the TMP; or (2) the 60th day after the day on which the settlement was entered into. Temp. Treas. Reg. § 301.6224(c)-3T(c)(3). However, a partner who has already entered into a closing agreement is contractually bound by its terms and cannot rescind the agreement so as to receive consistent treatment. Accordingly, unless there is a showing of fraud, malfeasance or misrepresentation of a material fact, the closing agreement cannot be rescinded.

III. Tax Court Jurisdiction

In their petition, the taxpayers alleged that the closing agreement was entered into by fraud. The statutory notice issued to the taxpayers for the [REDACTED] tax return gives the Tax Court jurisdiction to determine the validity of the closing agreement. Holmes & Jones v. Commissioner, 30 B.T.A. 74, 79 (1934). We agree with your conclusion that the Tax Court has jurisdiction to decide the validity of the closing agreement since the notice of deficiency had to be issued to assess the nonpartnership items on the [REDACTED] tax return. This is true notwithstanding the fact that the amendment to section 6230(a)(2)(ii) is effective as if included in the Tax Reform Act of 1986.

Where the Service and a taxpayer enter into a closing agreement subsequent to the enactment of TAMRA, the Service is authorized to make a computational adjustment without issuing a statutory notice of deficiency. I.R.C. §§ 6230 (a)(1) and 6231(b)(1)(C). In such a case, the Tax Court will not have authority to determine the closing agreement's validity since jurisdiction in the Tax Court is predicated only upon the issuance of a valid statutory notice. In determining whether the Service is, in fact, required to issue a statutory notice where the closing agreement is executed prior to the enactment of TAMRA, the date on which the statutory period expires is a key factor to be considered. In those cases where the statutory period for assessment would have expired prior to the date on which TAMRA was enacted, the Service would have been required to issue a statutory notice before assessing the deficiency. However, if the statute of limitations on making the assessment had not expired at the time of the enactment of TAMRA, the Service was no longer required to issue a statutory notice of deficiency prior to assessment and the Tax Court would not have jurisdiction to determine the validity of the closing agreement.

- 7 -

If you have any additional questions regarding this matter,
please do not hesitate to contact Vada Waters at (FTS) 566-3289.


CURTIS G. WILSON